



## Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact [support@jstor.org](mailto:support@jstor.org).

# THE EFFECT OF THE WAR ON NEW SECURITY ISSUES IN THE UNITED STATES

BY GORDON BLYTHE ANDERSON, A.M.,

Wharton School of Finance and Commerce, University of Pennsylvania.

The European war has thrown a tremendous burden upon the investment markets of the United States. In addition to the problem of making a place for new security issues of established corporations and of financing new enterprises, American investment bankers and their customers have been face to face with the necessity of purchasing an enormous aggregate of securities of American corporations heretofore held in foreign countries, and of absorbing over one billion dollars of the bonds of belligerent governments.

There is a limit to the amount of securities which the investors of a country can absorb. This limit, in the last analysis, is determined by the aggregate savings of business and professional men, added to the reinvestment of income derived from dividends and interest. It is an axiom of finance that when the supply of securities offered exceeds this amount a portion of them cannot be marketed. These undigested securities, as they are frequently termed, remain in the hands of underwriters and promoters, or clog up the collateral loans of banks, frequently laying the foundation for panics and other serious financial disturbances. When the investment market shows signs of an over-supply of securities, those least favored or offered on the most unfavorable terms, are passed by. The promotion of new enterprises is curtailed. Corporations postpone entering the financial market for new capital to finance extensions and improvements. In brief, the output of securities is diminished until the market is able to absorb a larger supply.

## VOLUME OF SECURITIES ISSUED DURING THE WAR

Has the output of securities in the United States been decreased as a result of the European war? The record of new

security issues for six years preceding the beginning of the European struggle and since that time, so far as available, follows:<sup>1</sup>

## NEW SECURITIES ISSUED IN THE UNITED STATES

(In thousands of dollars)

Year	Corporate	Municipal's, etc.	Total
1908	\$2,584,396	\$313,797	\$2,898,194
1909	3,247,609	339,424	3,587,034
1910	3,485,890	320,036	3,805,926
1911	3,576,919	396,859	3,973,778
1912	4,548,759	386,551	4,935,311
1913	3,179,990	403,246	3,583,236
1914 (Jan.-June)	1,580,460	355,998	1,936,459
1914 (July-Dec.)	751,004	110,376	861,381
1914 Total	2,331,465	466,375	2,797,840
1915 (Jan.-June)	1,335,721	320,394	1,656,116
1915 (July-Dec.)	1,625,887	167,567	1,793,454
1915 Total	1,961,609	487,961	2,449,571
1916 (Jan.-June)	2,807,056	275,740	3,082,796
1916 (July-Dec.)	613,780	57,739	671,520
1916 Total	3,420,837	333,480	3,754,317

The security market was slow in recovering from the effects of the panic of 1907, and we, therefore, find a steady and rather remarkable increase in the volume of securities floated in the years 1908, 1909 and 1910. The maximum security output was reached in 1912 when nearly \$5,000,000,000 of securities were floated. At this point the security market suffered a curtailment, and in 1913 security issues aggregating only \$3,500,000,000 were brought out. The record from that date is significant as reflecting the influence of general business conditions on the security market. In the first six months of 1914 a little less than \$2,000,000,000 of securities were marketed. During the last six months of the same year, after the outbreak of the war, financing fell off to \$861,000,000 making a total of considerably less than \$3,000,000,000 for the year. It is true, however, that in normal times, the last half of the year is less

<sup>1</sup> The figures for corporate securities were compiled from Babson's Desk Chart. The data concerning municipal issues were compiled from the *Commercial and Financial Chronicle*. The above computation takes no account of the repurchase of American securities held abroad, of the government loans effected by the European belligerents since August, 1914, or of issues of new corporations outside of the eastern states.

active in this line than the first half. During the first six months of 1915, or the second half-year of the war, there were issued over \$1,600,000,000 of securities. In the second half of 1915 nearly \$1,800,000,000 were brought out, the steady increase being due to the revival of business, caused by the industrial activity created by enormous war orders placed by foreign powers. During the first six months of 1916 we find the security market extremely active, over \$3,000,000,000 of securities being issued. July and August of 1916 reflect the same conditions as prevailed in former years with new financing slightly decreased. During August the flotation of motor stocks constituted a large part of the new financing. It must be remembered that the figures given on page 119 are not complete, for it is impossible to cover all new issues of securities. While a prophesy is dangerous and in most cases fruitless, yet unless there is a distinct change in financial conditions, the output of new securities in 1916 will closely approximate, if it does not exceed, the high water mark of 1912.

A review of the above comparison shows, in brief, that the first shock of the war radically curtailed the volume of new security issues, but under the stimulating influences which have existed since the advent of war orders and the return of industrial prosperity, the power of absorption of new securities is as great as in any previous period of our history. This record is all the more astonishing when we consider that since August, 1914, American investors have been called upon to absorb in addition over \$1,740,000,000 of European war loans and approximately \$1,300,000,000 of American securities formerly held abroad.

#### AMERICAN SECURITIES RETURNED TO OUR MARKET

Let us first take up the resale of American securities by foreign investors in the American market. The only accurate information at hand concerning foreign holdings of American securities is that compiled by President Loree, of the Delaware and Hudson Company.

Mr. Loree's figures give the par value of American railroad securities held abroad at different dates. Industrial or American municipal securities are not included in the figures submitted. One hundred and thirty-six railroad companies reported securities held abroad. On January 31, 1915, \$2,704,402,364 in par value of

## AMERICAN RAILROAD SECURITIES HELD ABROAD ON AUGUST 1, 1916.

Class of securities	Par value			Market value	
	July 31, 1916	July 31, 1915	Jan. 31, 1915 <sup>1</sup>	July 31, 1916	July 31, 1915 <sup>2</sup>
Preferred stock...	\$120,597,750	\$163,129,850	\$204,394,400	\$93,816,715	\$117,863,393
Second pref. stock	4,858,650	5,608,850	5,558,150	2,060,256	2,115,415
Common stock...	336,761,704	511,437,356	573,880,393	234,154,103	342,225,958
Notes.....	9,070,955	24,632,292	58,254,390	6,844,240	22,574,284
Debtenture bonds.	74,796,900	160,288,700	187,508,310	69,858,284	141,444,593
Coll'tl trust bonds	85,166,470	180,590,850	282,418,415	66,526,692	136,422,186
Mortgage bonds..	774,793,834	1,150,339,130	1,371,156,851	628,183,797	962,081,613
Equip. trust bonds	7,788,300	25,253,201	20,233,455	7,015,683	24,480,410
Car trusts.....	836,000	29,000	.....	681,320	29,000
Receivers' certifi's	958,000	2,201,000	998,000	958,000	2,201,000
Total.....	\$1,415,628,563	\$2,223,510,229	\$2,704,402,364	\$1,110,099,090	\$1,751,437,912

<sup>1</sup> Market value as of August 2, 1915.<sup>2</sup> No market value determined for first compilation.

American railway securities were held by foreigners. By July 31 of the same year the amount so held was reduced to \$2,223,510,229, showing that approximately \$500,000,000 were disposed of during these six months. The last figures obtainable, as of July 31, 1916, show that all but \$1,415,628,563 have been liquidated. From a study of these figures we see that nearly one-half of the railroad securities held by foreigners have come into American hands during the last eighteen months. If account is taken of industrial securities, municipal bonds and railroad securities owned abroad but standing in the name of American bankers holding them as agents, it is estimated that between \$1,500,000,000 and \$1,750,000,000 of American securities have been returned from abroad since the outbreak of the war, two years ago.

## NEW FOREIGN LOANS FLOATED HERE

The American investment market has been called upon to absorb between \$800,000,000 and \$1,000,000,000 of foreign-held securities a year. In view of the large output of new securities by domestic corporations, this record is most remarkable. But even this tremendous volume of securities does not measure the extent of the market which has prevailed during the last two years, for it does not take into consideration the floatation of the various loans in the United States by Canada, the Latin Americas, or the belligerent nations of Europe. The record of such financing, in so far as ascertained, is as follows:

Europe.....	\$1,300,000,000
Canada and Newfoundland.....	335,000,000
Latin America.....	105,000,000
<hr/>	
Total.....	\$1,740,000,000

This estimate indicates that there has been floated in the United States since the outbreak of the European war over \$1,740,000,000 of foreign public loans.

Has the foreign liquidation and the financing of the belligerents curtailed the financing of American corporations and municipalities? From the available data, the question must be answered in the negative, for the records show that more securities have been issued than was the case in the year preceding the war. It might be urged that a comparison based on the total issues of securities of all kinds, such as has been used, is not a fair index of the extent of the security market or of the degree to which the war has affected those securities which are entitled to rank as investments. A large proportion of the total capitalization represented in the above table is of a speculative nature. This portion represents the securities of new industrial corporations which have not established themselves as business enterprises, and where the capitalization is, therefore, in large part nothing but a claim to a share of anticipated profits, and to a good will of unknown value. If we separate railroads and industrial security issues and compare them by six-months' periods, we find that no facts are disclosed which impeach the conclusion that the security market has been one of large capacity.

The following table compiled by *The Journal of Commerce* classifies the financing of railroads and industrials for the six months (actual issues) and gives comparisons with a year ago.

RAILROADS			
	1916	1915	Change
Bonds.....	\$270,281,300	\$331,475,300	—\$61,194,000
Notes.....	209,205,000	135,708,800	+ 73,496,200
Stocks.....	26,203,400	5,485,000	+ 20,718,400
<hr/>			
Total.....	\$505,689,700	\$472,669,100	+\$33,020,600

## INDUSTRIAL CORPORATIONS

	1916	1915	Change
Bonds.....	\$300,232,300	\$159,194,500	+\$141,037,800
Notes.....	160,286,100	84,468,500	+ 75,817,600
Stocks.....	368,373,100	51,842,500	+ 316,530,600
Total.....	\$828,891,500	\$295,505,500	+\$533,386,000
Grand total.....	\$1,334,581,200	\$768,174,600	+\$566,406,600

The real effect of the European war upon the sale of securities by established American corporations has been to compel a higher interest rate. Large corporations have been compelled to compete for money with the foreign governments, which have been constantly increasing the rate which they will pay. With European war loans selling on a  $5\frac{1}{2}$  per cent basis or better and with Canadian loans marketed at prices yielding the investor above 5 per cent, it is obviously difficult, if not impossible, to market railroad bonds on a 4 per cent or  $4\frac{1}{2}$  per cent basis. As a matter of fact the most noticeable feature of American corporate borrowing has been the higher yields offered to the investing public. There is nothing in the situation at the present time which would support the conclusion that the end of this movement has been reached.

## THE DISPOSITION OF THESE SECURITIES

Have the investors of the United States absorbed the additional capital issues of American corporations and municipalities, the European liquidation of American securities and the foreign war loans floated in this country? If such absorption has occurred the general investment situation must be regarded as sound, but if, on the other hand, a considerable proportion of one or all of these groups remains unabsorbed, the situation must be regarded as unhealthy. Securities are not really marketed until they are actually sold to the investor. So long as they are in the hands of the underwriters or investment bankers they constitute an element which may prove dangerous in case of financial disturbance. In most cases securities in the hands of bankers and underwriters are pledged with national, state or private banks as collateral for loans, which is another way of saying that the money to purchase them from the corporations has been largely borrowed. An undue expansion of collateral loans would, therefore, be regarded as an unfavorable

symptom and indicative of the fact that the American investing public are being fed with securities faster than they can be absorbed. Unfortunately data concerning collateral loans of the national and state banks are not available for a later date than June 30, 1915. There is no way of telling at the present moment what expansion has occurred in this class of loans during the succeeding fifteen months.

#### COLLATERAL LOANS OF OUR BANKS

The collateral loans of the state banks for the year ending June 30, 1915 (covering the first ten months of the war) expanded \$133,000,000 over the loans reported in the previous year. The collateral loans of the national banks on June 30, 1914, aggregated \$2,409,805,178, of which \$1,036,976,740 were demand loans and \$1,372,828,438 were time loans. On June 30, 1915, the total collateral loans aggregated \$2,633,326,003. The increase occurred entirely in time loans, which would lead to the assumption that there was a larger "carry" of securities by investment bankers. It is not safe to presume, however, that the collateral loans entirely represent securities being thus carried. A large proportion of these loans represent the borrowing of business men and others for the purpose of financing their enterprises. Collateral loans of the national banks increased in volume from June, 1913 to June, 1914 some \$241,000,000. The increase in collateral loans in the year ending June, 1915 was \$224,000,000. It is reassuring to know that there was no unusual or abnormal increase in this year.

Much speculation is heard as to whether collateral loans have unduly expanded in the twelve months ending June, 1916. It is likely that there has been considerable expansion. An analysis of this expansion would to a large extent indicate whether America was carrying an unusual amount of undigested securities.

#### THEIR INVESTMENT HOLDINGS

In this connection it is interesting to analyze the investment holdings of our banking institutions. National and state banks, trust companies, private and savings institutions constitute one of the largest classes of bond buyers. If we group the banks outside of the national banking system, that is to say, the state, mutual savings banks, private banks, and loan and trust companies, we

find that over a period of five years ending June, 1915, their holdings of state, county, municipal, railroad, public utility and other bonds—except United States bonds—have increased from \$1,112,553,992 in 1911 to \$1,346,613,857 in 1915. It is impossible to say what changes have occurred in this account for the year ending June 30, 1916.

The national banks in June, 1913, held \$1,050,587,650 of bonds, other than United States bonds. According to the last statement preceding the outbreak of the war, June, 1914, the bond holdings aggregated \$1,015,981,900. A year later the total bond holdings were \$1,191,128,000. In June, 1916 the bond holdings were \$1,528,832,000, an increase in twelve months of \$337,704,000. In the same period deposits increased \$1,500,000,000 and the total resources of national banks increased \$2,100,000,000. Certainly it could not be contended that an increase in bond investments of the amount indicated above is excessive, in view of the tremendous growth in deposits and resources of national banks.

#### THE WAR AND FINANCIAL CONDITIONS

With this general review of the statistical progress of the security market we turn to a more detailed examination of the effect of the war upon investment conditions. It will be remembered that the first important effect after the outbreak of the war and continuing for practically all of the last five months of 1914 was the paralysis of the investment market which did not resume any activity until after the opening of the stock exchange on November 28. Foreign commerce was demoralized. It was not until one power controlled the sea that we find it again on the upward trend. The foreign exchange situation became very acute and developed to a point where the American dollar had greatly depreciated in terms of the English pound. This situation was greatly relieved by the operation of the \$100,000,000 gold pool and the exportation of gold in large quantities from the United States to England and Canada. This embarrassing foreign exchange situation was brought about by the falling off in our exports and also by the effect of the moratoria declared by the various belligerent nations. Americans were forced to pay debts abroad which were due, but on the other hand were not receiving remittances of debts due by foreign merchants. Later the foreign exchange situation was reversed. Even though

the moratoria in some cases were extended, the large exports of American goods called for payments which the foreigner was not meeting with the shipment of commodities, but was forced to meet with shipments of gold. England and France were very unwilling to release any large part of their gold holdings for it reduced their ability to extend credit, and finance war obligations in their own country. Hence English and French merchants were forced to pay a very high price for bills of exchange with which to settle their debts in the United States.

The situation became serious. Although the United States was the recipient of large importations of gold, even this did not check the fall in sterling exchange, and it was not until the flotation of the \$500,000,000 Anglo-French loan in this country that sterling exchange recovered to any extent. Even at this time the English pound is greatly depreciated in terms of the American dollar, but due to further credits arranged with American bankers, the pound sterling has not fluctuated widely. Even though quotations do not resemble normal times, the difference does not lie wholly in the visible balance of trade.

Following the close of the London and New York stock exchanges and the paralysis of our foreign commerce, we find a complete disorganization of American business. Bankers were not prone to encourage extensive business operations at this time, nor was the business man anxious to increase his facilities, for in many cases he found himself with large stocks of goods on hand and little work for his plant because of cancelled orders. This condition necessarily led to unemployment and a consequent flooding of the labor market. Manufacturers were not making money and business suffered a depression which is sometimes referred to as the depression of 1914. In this depression many companies lowered and in some cases suspended their dividends. This destroyed the basis of financing new issues.

#### EFFECT ON THE MARKETS

The bond market reflected this condition. It is very difficult to determine to what extent the prices of securities fell, because of the "pegged" quotations during the suspension of stock exchange operations. Generally the tone was not optimistic. With the placing of large war orders business was revived in certain industries,

and soon acted as a general stimulus to all trade. The manufacturer found himself in the position where he could sell at his own price, instead of at a bargain, and this situation necessarily meant larger profits. The labor market was directly affected, for the demand for labor was steadily increasing, and the growing assurance that America could withstand the strain and irregularities caused by the European struggle brought about a return of public confidence. The opening of the stock exchanges marks the end of the period of fear and distrust. The banks had large surplus reserves and money was very cheap, so that the American manufacturer was able to finance his operations at a low cost, so far as short-term loans were concerned. When the foreign exchange situation turned in our favor, that is when sterling exchange crossed the par point, it signified that our commerce was moving in sufficient volume to liquidate our indebtedness and that we were able to realize on goods which had been tied up temporarily and also on new goods which were being manufactured on foreign order.

At this time the investor was looking for bargains in securities. He anticipated heavy European liquidation of standard securities at low prices, and even though banks were making short-term loans at low rates, it was very difficult for the railroads of the United States to float long-term issues. Therein comes the distinction between floating and permanent or fixed capital, for while the banks were lending at comparatively low rates the investment market was looking for a higher yield, which prevented normal issues of new capital from being sold. The railroads were not strongly bidding for investment funds because the business depression was still continuing to a diminishing extent, and they had not as yet shared in the prosperity which had affected but few industries. Judging from the idle car figures, and also from earnings, the railroad situation was becoming worse from month to month as the war continued. It was not until the early summer of 1915, according to the foregoing barometers, that they began to share to any appreciable extent in the activity of American commerce. Since that time, with the exception of the month of June, the number of idle cars has decreased until at the present writing figures indicate that a car shortage is imminent.

## RAILROADS, PUBLIC UTILITIES AND MUNICIPALITIES

The fact that the railroads had a great many idle cars also signified that their terminal and track facilities were not wholly used and hence they did not need new capital in large amounts to extend such facilities. Operations under construction at the beginning of the war were in many instances discontinued or curtailed. Generally new propositions were not undertaken for two reasons: first, because of the period of uncertainty; and second, because of the inability to get capital on favorable terms, since the American investor was holding off to wait for bargains in American securities held by foreigners rather than buy new securities issued for the extension of work in the United States.

Practically the same situation existed in the public utility field. Street railway earnings were lagging which is usually the case during any period of unemployment. The working man was not riding as frequently, and the earnings of electric light and gas companies were directly affected because the public was economizing. This is especially true in certain localities particularly the middle west. These factors stunted the demand for new capital to be used for additions and extensions in this field. However certain standard properties, of which the Detroit-Edison is an example, successfully disposed of securities during the period. In most cases these securities had a vogue due to the established business of the issuing company.

The market in municipals was slow. This market is largely an institutional market and quickly reflects general business conditions. In periods of depression there is a falling off in savings and a hesitancy to invest in a falling bond market. With the improvement in labor conditions and an increased prosperity in the industrial field we find this market improving.

During the year 1915 the United States was called upon to finance foreign governments. Canada, which theretofore had disposed of practically all of its securities in England, turned to us in order to sell its public bonds. The proposition which they offered was very attractive, because of the high interest rates. American bankers also took Argentine loans aggregating \$79,000,000.

War orders had given tremendous impetus to American business. The Allies were buying at a rate of which the public had no conception. It will be remembered what a sensation the size of the

Anglo-French loan caused, for it disclosed in part the huge operations which America was conducting for the allied powers. Continuous liquidation of foreign-held American securities kept the prices of railroad stocks and bonds down. These foreign security holdings were very attractive, first, as to price, and second, because the railroads were now showing a better margin of earnings, and therefore, were a safer investment than heretofore.

The continued importation of gold increased the lending power of our banks enabling the easy money market to continue. The industrial boom meant profits to the manufacturer and it may be safely assumed that the business man absorbed a great many securities, for the business man's investments are determined by his profits. The Anglo-French loan was underwritten with apparent ease, but the syndicate could not liquidate fast enough without beating down the price of these securities. If the syndicate had been any less powerful, the loan probably would not have been absorbed so quickly. The underwriters took their shares at once, gradually disposing of the bonds as a market could be found for them among individual investors and later we find part of the loan being disbursed as dividends by manufacturers of explosives.

#### ABSORPTION OF SECURITIES A SERIOUS PROBLEM

Experience showed that the American investor was slow to take the securities of foreign governments, for he feared repudiation, and, moreover, expected collateral security which has been the basis for issuing some of the later loans.

Tremendous speculation in industrial shares, especially in stocks of manufacturers of munitions and automobiles, brought into being industrial combinations and new companies. This marked a period of increasing prices in stocks, but a careful study of our general security market reveals the fact that with the exception of the "war stocks" the rise has not been as general as people have been made to believe. The year 1916 opened with a continued good bond market lasting throughout the first six months. Early in 1916 the municipal bonds and public securities generally were very popular because of the income tax regulation exempting them from taxation. Bank interest rates were higher than before the war. Continued European liquidation did not seem to affect the market for new securities. The period is also marked by additional

financing of European powers. The later foreign loans and the liquidation of foreign-held American securities have had to compete with new issues of railroad, public utility and other corporate securities issued at higher rates of interest, which absorbed a large part of the investment fund of the United States.

As to the future no one can prophesy what will happen in the investment market. War orders are continuing, but increased wages and the forcing of shorter hours upon American business have increased the cost of production and doubtless decreased profits. An increased demand has raised the cost of raw materials, therefore directly affecting the situation. Nevertheless, the country is very prosperous and the investment fund necessarily large. If the European liquidation goes on to the end it may stunt the market for new securities of railroads and public utilities, but in view of the increased business in the United States we have reached the point where we must have new fixed capital in these industries, therefore, increasing competition between these two groups of securities may be expected. It is very likely that a large part of the current sluggishness in the American security market, if it can be called sluggish, is due to labor troubles. This situation makes the investor pessimistic and leads to market uncertainty. Large investment bankers avoid commitments fearing that market conditions may radically change before they can sell that which they have bought. The writer has purposely omitted any discussion of the Mexican situation and also the national political situation as influencing the marketing of new securities in the United States.

In conclusion several effects may be noted. American corporations have lost the investment fund of foreign countries. The United States is practically dependent upon the investment demands of its own people. In addition to financing local necessities we doubtless must absorb securities formerly owned by foreign investors. As this is accomplished we are gradually converting our country into a creditor nation. The railroads have suffered, because of the competition which their securities have had to meet, at certain periods during the war. It is possible that this class of security will have to be offered on a more attractive basis. In the long run it should be comparatively easy to finance American enterprises entirely with American capital.